

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF THE APPLICATION OF
IDAHO POWER COMPANY FOR APPROVAL
OF AN AGREEMENT FOR SALE AND
PURCHASE OF ELECTRIC ENERGY
BETWEEN IDAHO POWER COMPANY AND
RENEWABLE ENERGY OF IDAHO, INC.**

CASE NO. IPC-E-04-5

ORDER NO. 29487

On February 19, 2004, Idaho Power Company (Idaho Power; Company) filed an Application with the Idaho Public Utilities Commission (Commission) requesting approval of a Firm Energy Sales Agreement (Agreement) between Idaho Power and Renewable Energy of Idaho, Inc. (Renewable Energy) dated February 12, 2004. The Commission in this Order approves the submitted Agreement and reminds the Company of its obligation to follow Commission orders and to compute avoided cost rates in accordance with Commission approved avoided cost methodology.

Renewable Energy proposes to design, construct, install, own, operate and maintain a 17.5 megawatt (MW) biomass (primarily wood waste) generating facility to be located at the old Boise Cascade Plant site near Emmett, Idaho (the Project). The Project will be a qualified small power production facility (QF) under the Public Utilities Regulatory Policies Act of 1978 (PURPA).

Under the terms of the Agreement, Renewable Energy has elected to contract with Idaho Power for a 20-year term. The Agreement contains non-levelized published avoided cost rates as currently established by the Commission for energy less than 10 MW and a negotiated price for energy over 10 MW.

As in recent prior submitted agreements, Idaho Power utilizes a cogeneration small power producer (CSPP; QF) agreement that is consistent for all CSPP projects regardless of their resource (wind, hydro, geothermal, wood waste, etc.) and that incorporates (1) current IPUC Orders, (2) current technologies, and (3) current utility industry standards. The submitted Agreement, the Company states, contains many of these concepts as well as unique negotiated provisions due to the fact that the Project wishes to routinely deliver more than 10 MW to Idaho Power. The following is a brief description of some of these concepts and unique provisions:

A: Ten MW or Smaller Project Size and Eligibility for the Published Avoided Cost Rate: Noting that the Commission has established a 10 MW size limit for PURPA projects eligible for QF published avoided cost rates, Idaho Power points out that the Commission did not specify how the 10 MW limit was to be measured. Historically, the nameplate rating of the facility has been considered to be the measurement for this limit. Idaho Power suggests in this filing that it is reasonable that this limitation be based on that energy delivery to the utility and not nameplate rating.

Many QF facilities, due to less than 100% capacity factors and unknown incremental fuel supplies, the Company contends, are not able to commit to a long-term firm commitment of the incremental energy production above 10 MW. To address this issue, Idaho Power has developed the concept of "Optional Energy." The concept of Optional Energy, the Company contends, maintains the integrity of the 10 MW limitation and the QF published avoided cost rates but also allows the project developer the ability to assess its specific facility's performance, capital cost and other risk/benefit factors in designing the size of the QF's individual facilities.

Optional Energy is all energy that the Project delivers to Idaho Power that exceeds 10,000-kilowatt hours in a single hour, typically non-firm energy, as defined in ¶ 1.18 of the Agreement. Optional Energy is identified through hourly metering. The price of this energy is a price negotiated between Idaho Power and the specific project. As non-firm energy, Idaho Power considers the value of this energy to be a variable current month market based price.

Renewable Energy requested that fixed prices be established for its Optional Energy rather than receiving the monthly variable market prices. Idaho Power and Renewable Energy, therefore, negotiated fixed prices for the Optional Energy (Section 7.5 of the Agreement) in consideration of the Project providing year-ahead firm commitments of the monthly Optional Energy amounts (Section 6.4 of the Agreement).

Also applied to this Optional Energy are Company-developed Shortfall and Surplus Energy concepts (Sections 7.7 and 7.8 of the Agreement), as previously included in the Company's Tiber Montana LLC contract approved by the Commission in Order No. 29232 and the recently submitted Agreement with United Materials of Great Falls, Inc. (Case No. IPC-E-04-1).

B. Seasonality: As an incentive for Renewable Energy to deliver energy to the Company during times when it is of greater value to Idaho Power, the Company has refined the

seasonal rates to coincide to the months in which Idaho Power has identified actual energy needs and periods of higher demand. Reference Agreement Sections 6.2, 7.1 and 7.5.

C. Environmental Attributes: As reflected in Agreement Section 8, Idaho Power notes that it has filed a Petition with the Commission in Case No. IPC-E-04-2 seeking a Commission ruling concerning whether the environmental attributes associated with a QF project are owned by the project or the utility at the time a utility purchases electricity from a QF project. The Commission's final Order will be included and become an integral part of the Agreement. Renewable Energy reserves the right to cancel the Agreement within 30 days of the Commission's final Order regarding Idaho Power's Petition.

Agreement Section 24 provides that the Agreement will not become effective until the Commission has approved without change all the Agreement terms and conditions and declared that all payments that Idaho Power makes for purchases of energy to Renewable Energy will be allowed as prudently incurred expenses for ratemaking purposes. Should the Commission approve the Agreement, Idaho Power intends to consider the effective date of the Agreement to be February 12, 2004. As reflected in the Company's Application, the Agreement contains non-levelized published avoided cost rates in conformity with applicable Commission Orders.

Idaho Power requests that the Commission issue an Order approving the Firm Energy Sales Agreement between Idaho Power Company and Renewable Energy of Idaho, Inc. without change or condition. The Company further requests a Commission finding that all payments for purchases of energy under the Agreement will be allowed as prudently incurred expenses for ratemaking purposes.

On March 16, 2004, the Commission issued Notices of Application and Modified Procedure in Case No. IPC-E-04-5. The deadline for filing written comments was April 7, 2004. The Commission Staff was the only party to file comments. Reply comments were filed by Idaho Power and Renewable Energy. The comments can be summarized as follows:

COMMISSION STAFF

Staff contends that the Company has failed to follow the Commission's Orders regarding how avoided cost rates are to be determined for QFs 10 MW and larger and has instead negotiated a rate based on comparisons to forward market prices and recent Idaho Power contract purchases. Because the rates contained in the Agreement have not been determined in

accordance with the approved Commission avoided cost methodology, Staff recommends that the submitted Agreement be disapproved. Staff recommends that Idaho Power be directed to compute an avoided cost rate in accordance with the prescribed methodology, resume contract negotiations with Renewable Energy, and submit a revised agreement for Commission consideration.

The avoided cost methodology for QF projects 10 MW and larger is an IRP-based methodology requiring the utility to make two runs of its power supply model, one using assumptions consistent with its most recent IRP, and a second with the proposed QF included as a no-cost resource. The difference in net power supply cost computed by the model over the term of the proposed contract represents the value of the QF to the utility and is supposed to serve as the basis for establishing an avoided cost rate for the proposed QF. The methodology is intended to capture and fairly value the different individual generation characteristics of proposed projects. The IRP-based methodology was set forth in a Settlement Stipulation approved by the Commission in Order No. 26576 issued September, 1996 in Case No. IPC-E-95-9. In the same Order accepting the Settlement Stipulation, the Commission also reduced maximum contract lengths from 20 years to five years. Staff maintains that the Settlement Stipulation was developed and signed when contract length was still 20 years, and that the methodology in the Stipulation was clearly designed to be used for long-term, rather than short-term contracts (e.g., 20-year rather than 5-year contracts). Staff contends that the IRP methodology was chosen specifically because the parties felt that it more accurately reflected the value of a large QF to the utility and was more appropriate than the SAR-based method for large projects and long-term contracts.

Staff asked Idaho Power specifically to compute rates for Renewable Energy using AURORA, the power supply model the Company is currently using for various types of analyses. The Company contends that the AURORA model is currently being extensively updated for use in the 2004 IRP and is simply not available to perform the requested analysis in the near future. The Company responded "the process described in the referenced Settlement Stipulation is not a valid method for setting 20-year avoided costs for QF projects and [the Company] did not use forecast models to negotiate rates with Renewable Energy." Because Idaho Power has AURORA, has used it in the past, has used it in its present rate case, and is

using it for its upcoming 2004 IRP, Staff sees no acceptable reason why the model cannot be used in this contract case.

Rather than following the avoided cost methodology prescribed in the Settlement Stipulation approved in Commission Order No. 26576, Idaho Power offered Renewable Energy a non-levelized published avoided cost rate for the first MW and offered an Optional Energy Rate for generation above 10 MW. Idaho Power established three criteria to judge the reasonableness of the negotiated Optional Base Energy price.

1. The Optional Base Energy price must be less than the current non-levelized published avoided cost;
2. The Optional Base Energy price must not exceed forward price curves for Idaho Power's system border prices for the years that a forward price curve is available;
3. The Optional Base Energy price must not exceed Commission-approved Idaho Power energy purchase prices. The PPL Montana energy purchase agreement was recently approved by the Commission and was used for this comparison.

In order to evaluate the negotiated Optional Base Energy price against these three criteria, equivalent energy products and prices had to be established to provide like-kind comparisons. Once the comparable products and prices were established, Idaho Power negotiated a price that met the three initial criteria. Seasonality was applied to the negotiated price in the same manner as it is applied to the non-levelized published avoided cost. An annual escalation factor of 1% was negotiated for the Optional Base Energy prices. This compares to an annual escalation rate of approximately 2.3% for the non-levelized published avoided costs approved by the Commission.

While Staff finds that the contract prices and related criteria are not necessarily unreasonable, Staff contends the fact remains that the Company failed to follow Commission Orders in developing an avoided cost rate for Renewable Energy's greater than 10 MW project. Staff contends that it is presumptuous of the Company as set forth in the Company's response to a Staff production request to dismiss the Commission-approved methodology as no longer valid without even making an attempt to compute rates in accordance with the methodology. If rates had been computed in accordance with the methodology and then were judged unreasonable, Staff might agree that an alternate method was warranted. That was not the case here, however.

IDAHO POWER REPLY

Idaho Power assures the Commission that it was not the Company's intention in negotiating rates with Renewable Energy to disregard the Commission's Order No. 26576 avoided cost methodology for projects larger than 10 MW. Staff's Comments, the Company concedes, correctly note that a Commission Order remains in effect until it is changed by Commission Order. In the negotiation of the contract with Renewable Energy, the Company states that it did not utilize the AURORA model to attempt to compute avoided cost rates for Renewable Energy for two principal reasons:

1. At the time Renewable Energy approached Idaho Power for a contract, the Company had not utilized the AURORA model to generate avoided costs. Idaho Power had used the AURORA model for some resource expansion comparisons but it did not believe that it had sufficient experience with the AURORA model to rely on the model to accurately determine avoided costs.
2. Renewable Energy was extremely anxious to execute a contract with Idaho Power so that it could move forward with the development of its project. The Company was concerned that taking the time necessary to modify and test the AURORA model to perform the precise cost-benefit analysis required by the methodology described in Commission Order No. 26576 would have significantly delayed the development of a contract for the Renewable Energy project.

For the above reasons, Idaho Power utilized the Commission-approved energy purchase rates for a QF project smaller than ten (10) MW as the starting point for negotiations with Renewable Energy. Idaho Power does not know whether making the two AURORA runs in the manner described in Order No. 26576 would result in energy purchase prices that are higher or lower than the negotiated purchase prices contained in the Renewable Energy contract filed with the Commission.

While Idaho Power believes that AURORA can successfully provide the more general analysis needed for IRP purposes, the Company is not confident that it has sufficiently tested AURORA to conclude that two runs of the AURORA model, one with the QF project included and one without, would, in fact, produce pricing and cost data that would precisely quantify the costs that Idaho Power would avoid over a 20-year period if it acquired a QF resource rather than building another resource or purchasing wholesale power in an amount equivalent to the QF resources output.

Idaho Power notes that about the time that Renewable Energy approached the Company concerning the QF contract, the person who was most experienced in operating the AURORA model had recently left the Company's employment. The Company was in the process of training new people to operate the AURORA model.

Idaho Power notes also that currently the AURORA model is being run almost constantly in preparing the Company's 2004 IRP. It is the Company's intention as soon as the 2004 IRP process is completed, to turn its full intention to the AURORA model to make a final determination whether (1) the AURORA model outputs are sufficiently consistent with actual system experience that the output of the model would be a reliable predictor of costs a utility can avoid by adding a specific large QF resource over a 20-year period, or (2) the AURORA model cannot be used for this purpose and some alternative must be developed. If the Company ultimately determines that the AURORA model cannot be used in the way contemplated in Order No. 26576, the Company intends to advise the Commission of that fact and seek modification of the methodology. The Company acknowledges that Order No. 26576 has not been rescinded or changed by the Commission and is still in effect.

In the final analysis, the Company states that the Commission must decide if the filed Agreement between Idaho Power and Renewable Energy is in the public interest. Idaho Power submits that because the purchased rates in the Renewable Energy contract in total are less than the currently approved avoided cost rates for smaller QFs, the rates are reasonable. Idaho Power believes that taken as a whole, the prices, terms and conditions contained in the Renewable Energy Agreement are reasonable and that the Agreement should be approved.

RENEWABLE ENERGY REPLY

Renewable Energy expresses concern that its project is in the center of a dispute, not of its making, between a well-intentioned Staff and Idaho Power. Renewable Energy and Idaho Power, it states, have been in negotiations over the rates and terms contained in the submitted Agreement for over seven months at a cost of many thousands of dollars. Many concessions were made on Renewable Energy's part to expedite the process. The reason for Renewable Energy's acquiescence is that time is critically important. The proposed project is a wood waste burning facility on which the U.S. Forest Service and Bureau of Land Management are relying to dispose of surplus waste forest materials created as a result of Congress's Healthy Forest mandate. Delaying the on-line date for this facility could jeopardize the project's viability. Site

preparation work has already commenced in Emmett. Renewable Energy urges the Commission to approve the Agreement based on the good faith efforts of both Idaho Power and Renewable Energy. If the Commission believes the avoided cost methodology adopted in Order No. 26576 remains applicable, it is recommended the Commission declare it applicable for future contracts and not apply it retroactively to Renewable Energy's Agreement with Idaho Power.

Renewable Energy states that it has secured sufficient fuel to operate this project at the 17 MW level. There are no physical or operational constraints, however, that require Renewable Energy to locate all 17 MW of production at a single location. The economies captured by Renewable Energy by using a single location for its project, however, are what permitted Renewable Energy to accept rates that are actually lower than the published avoided cost rates. In order to keep the project viable and avoid the months of delay that will ensue while Idaho Power compiles the data necessary to revive the AURORA model, Renewable Energy states that it is now actively seeking a second site to begin construction of two separate QF projects. One 10 MW project would be located at the old Boise Cascade Mill Site in Emmett. The second, a somewhat smaller QF, would be located at a new location. The end result would be that Renewable Energy would suffer from lost economies caused by consuming its fuel source at two different sites and that ratepayers would suffer from paying a higher avoided cost rate for a 10 and 7 MW project. Renewable Energy contends that the 20-year difference in contract and posted rates is approximately \$25 million.

A unique and very beneficial feature of the submitted Agreement, Renewable Energy contends, is that the QF has agreed to only operate in Seasons Two and Three which are the seasons Idaho Power is most in need of power in the Treasure Valley. Renewable Energy urges the Commission to exercise its discretion and approve a negotiated Agreement which provides benefits to Idaho Power and its ratepayers.

It is Renewable Energy's hope that the Commission will look to the spirit and intent of its Orders and recognize Staff's comment that "the contract prices developed by Idaho Power are not necessarily unreasonable." Given the fact that Renewable Energy is actually able to seek two separate Agreements and therefore legally increase the contract prices to full avoided cost rates should be considered by the Commission, Renewable Energy contends, as evidence of the contract prices being per se reasonable.

COMMISSION FINDINGS

The Commission has reviewed the filings of record in Case No. IPC-E-04-5 including the underlying Agreement, the comments and recommendations of the Commission Staff and the Reply Comments of Idaho Power and Renewable Energy. Based on our review of the record, we continue to find it appropriate to process this case pursuant to Modified Procedure. IDAPA 31.01.01.204.

Idaho Power in this case requests Commission approval of a PURPA Firm Energy Sales Agreement with Renewable Energy of Idaho, Inc. The proposed project is a 17.5 megawatt biomass generating facility to be located at the old Boise Cascade Plant site near Emmett, Idaho. Rates in the submitted Agreement were not calculated pursuant to the IRP-based methodology established for large QF projects (i.e., projects greater than 10 MW). Instead, the Agreement contains non-levelized published avoided cost rates for all energy less than 10 MW and a negotiated price for all energy over 10 MW.

The Commission Staff recommends that the submitted Agreement be disapproved. Staff recommends that Idaho Power be directed to compute an avoided cost rate in accordance with the prescribed methodology, resume contract negotiations with Renewable Energy and submit a revised Agreement for Commission consideration.

Idaho Power acknowledges that the avoided cost methodology established in Order No. 26576 has not been rescinded or changed by the Commission and is still in effect. The Company admits that it did not use the methodology in calculating rates and sets forth in its Reply its reasons for failing to do so. Idaho Power states it does not know whether the rates would be higher or lower using the IRP-based methodology. Idaho Power submits that because the purchase rates in the Renewable Energy contract in total are less than the currently approved avoided cost rates for smaller QFs, the rates are reasonable. The Company recommends that the Agreement be approved.

Renewable Energy contends that it negotiated in good faith, and has made concessions to obtain a speedy contract. If the Agreement is not approved, Renewable Energy contends that it will incur expenses and that the project's viability may be jeopardized. Site preparation has already begun in Emmett and the QF is looking for a second site to potentially develop the project as separate 10 and 7 MW facilities. If developed in that manner, the available rates for the two facilities would be the higher posted rates available to QFs 10 MW

and smaller. The developer estimates the difference in cost to ratepayers (contract rates versus posted rates) over the 20-year project life is approximately \$25 million.

Idaho Power's failure to follow Commission-approved avoided cost methodology for calculating Renewable Energy rates or request changes in that methodology, we find, is both unacceptable and inexcusable. The Company and its employees are presumed to be aware of the requirements in the Commission's Orders and the consequences of failing to follow them. Idaho Code Title 61, Chapter 7—Public Utilities Law—Enforcement and Penalties. If the Company believes that the IRP-based methodology approved in Order No. 26576 is no longer valid, then it is incumbent upon the Company to make a filing with the Commission and request changes. As the Company is well aware, utility purchases under PURPA are mandatory. Such purchases, however, are to be priced at the Commission-determined avoided cost rate for QFs smaller than 10 MW or pursuant to approved IRP-based methodology for QFs larger than 10 MW. Should the Company choose not to follow avoided cost methodology in its contracting practice, it does so at risk of having the contract regarded by this Commission as a voluntary purchase.

Idaho Power in its Reply states that it does not know whether the IRP-based methodology would result in a higher or lower rate for Renewable Energy. We are asked to accept the rate as being *per se* reasonable based on a comparison to the posted rate. Such a comparison, we find, provides only one element of consideration in determining reasonableness. It is not by itself persuasive. What is persuasive in this case is the unfairness of holding the QF project hostage for the failure of the utility to follow the Commission-approved avoided cost methodology. The Project's viability, as configured, is dependent on the timely approval of the submitted Agreement. An additional persuasive factor in this case is the fall-back option available to Renewable Energy to change the 17.5 MW project configuration at the Emmett site to two smaller configurations, each qualifying for posted rates, one at Emmett and the second at a different site. Clearly this result is in the interest of neither the QF developer who would be required to develop two project sites and sacrifice economies of scale, nor the Company and/or its customers who would be required to pay an amount significantly greater than the negotiated contract price for an equivalent amount of energy over the 20 year contract term.

Of significance also in our decision-making is Staff's assessment that the contract prices and related criteria are "not necessarily unreasonable." Staff's qualified assessment of the contract rates is a result of the Company's refusal to provide an IRP-based calculation. We

regret that the Company has placed Renewable Energy, Staff and the Commission in this position. For the reasons cited, however, even though an element of uncertainty exists, we find it reasonable to approve the submitted Agreement. The Agreement terms we consider are presented in the context of a negotiated and mutually accepted contract. Our decision in this case sets no precedent for our future regulation of such Agreements or the utility. We find it reasonable based on our review of the Agreement and the filings of record to allow payments made under the Agreement as prudently incurred expenses for ratemaking purposes.

CONCLUSIONS OF LAW

The Idaho Public Utilities Commission has jurisdiction over Idaho Power Company, an electric utility, pursuant to the authority and power granted it under Title 61 of the Idaho Code and the Public Utility Policies Act of 1978 (PURPA).

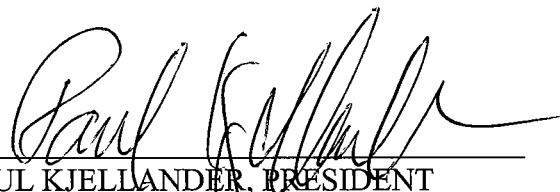
The Commission has authority under PURPA and the implementing regulations of the Federal Energy Regulatory Commission (FERC) to set avoided costs, to order electric utilities to enter into fixed term obligations for the purchase of energy from qualified facilities, and to implement FERC rules.

ORDER

In consideration of the foregoing and as more particularly described and qualified above, IT IS HEREBY ORDERED and the Commission does hereby approve the February 12, 2004, Firm Energy Sales Agreement between Idaho Power Company and Renewable Energy of Idaho, Inc.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 4th
day of May 2004.



PAUL KJELLANDER, PRESIDENT

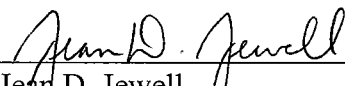


MARSHA H. SMITH, COMMISSIONER



DENNIS S. HANSEN, COMMISSIONER

ATTEST:



Jean D. Jewell
Commission Secretary

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